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SUBJECT: MACROECONOMIC NEWS: ARMENIA'S DOUBLE-DIGIT GROWTH
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SUMMARY

1. (SBU) Based on raw data provided by the National Statistical Service, Armenia's economy grew by 10.2 percent in the first six months of 2005 (compared to the same period in 2004). The inflation rate during the same period was 2.3 percent. Budget revenues and expenditures increased by 25.4 and 21.5 percent respectively, but tax revenue as a percentage of GDP remained low at 18.9 percent. Budget expenditures on education and health were low, 3.4 and 1.7 percent of GDP respectively. Foreign investments in Armenia grew by 11.6 percent (primarily because a new Lebanese mobile telephone operator entered the market). Despite the fluctuations in foreign exchange rates, both exports and imports grew steadily at rates of 28.4 and 26.2 percent respectively. Imports were almost twice as large as exports in nominal terms. The GOAM continued to service its foreign debt, reducing the debt by USD 68.4 million during the first six months of 2005. End Summary.

MACROECONOMIC OVERVIEW: STRONG GDP GROWTH

2. (SBU) The GDP grew at an impressive 10.2 percent (compared to the same period in 2004) during the first six months of 2005, exceeding the GOAM forecast for annual growth of 8 percent. As in previous years, construction was the primary GDP driver constituting 43 percent of overall growth. Agriculture made up 10.2 percent of overall growth and industry contributed 5.3 percent. Construction spending totaled USD 251.6 million and was largely privately financed (91.5 percent). The construction boom is likely to slow down during the winter months and to surge again in Spring 2006 in part because the Lincy Foundation has pledged USD 60 million largely for construction projects due to start around that time. Industrial sector growth was based primarily in metallurgy (45.2 percent).

PRICES DECREASE

3. (SBU) The abundant agricultural harvest continued to drive down food prices resulting in deflation of 1.4 percent in June and a total inflation rate of 2.3 percent for January-June 2005. The price index for agricultural products in June decreased by 20.7 percent compared to the previous month. Inflation in Armenia is usually cyclical because a large portion of the consumer basket is made up of food which is cheaper during the summer months. Prices for construction materials rose by 15.2 percent during the first six months of 2005. This trend is expected to continue through the fall. Given rising fuel prices and the cyclical nature of inflation in Armenia, the government remains likely to meet its three percent inflation target by year's end.

BUDGET REVENUES AND EXPENSES INCREASE

4. (SBU) According to consolidated budget data provided by the National Statistics Service, which is generally considered to be objective and relatively accurate, budget revenues for the first six months of 2005 were USD 422.55 million (up by 25.4 percent over the same period of last year). Expenses totaled USD 422.05 million (an increase of 21.5 percent). Collected tax revenues were USD 292.71 million (up by 20.8 percent). The increase was due largely to increased VAT collections which reached USD 132.25 million (up 18.8 percent) and increased corporate tax collections which reached USD 49.88 million (up 62.9 percent). Indirect taxes, such as VAT and excise taxes, fell as a share of total tax revenues from 62.7 percent for

January-June 2004 to 57.4 percent in January-June 2005. Expenditures on education and science increased substantially to USD 22.44 million or 3.4 percent of GDP compared to 2.7 percent in the last six months of 2004. Despite a slight increase in health expenditures to USD 9.32 million, the share of health expenditures to GDP remained very low: 1.7 percent in 2005 compared to 1.5 percent in 2004.

FOREIGN TRADE EXPANDS

15. (SBU) Foreign trade continued to grow during the first six months of 2005. Exports increased to USD 429.12 million (28.4 percent more than the same period last year) and imports grew to USD 787.96 million (26.2 percent growth over the same period last year). Armenia's primary trade partners remained Russia (14 percent of total trade), Belgium (12.3 percent), Israel (9.9 percent) and Germany (9.5 percent). Non-diamond exports were valued at USD 290.80 million (a 31.3 percent increase over the same period last year). Non-diamond imports were valued at USD 634.3 million (a 24.2 percent increase over the same period last year).

FOREIGN INVESTMENTS GROW

16. (SBU) Foreign investments increased by 11.6 percent during the first six months of 2005, and reached USD 139.6 million. The largest investments were in telecommunications. Greek-owned Armentel invested USD 58.3 millions (41.7 percent of the total investment growth), and a new Lebanese mobile telephone operator, VIVACELL, entered the market with an investments of USD 20 million (14.3 percent of the total investment growth). The other major investors by country remained Russia (USD 13.5 million), USA (USD 9.3 million), France (USD 8.8 million), Cyprus (USD 7.6 million) and Argentine (USD 4.6 million).

REDUCTION IN FOREIGN DEBT

17. (SBU) Armenia's foreign debt as of June 30, 2005 was USD 1,114.5 million -- down by USD 68.4 million since the end of 2004. The majority of the debt is owed to the World Bank (67.4 percent), and IMF (17.3 percent). Other creditors include the German development bank and the International Fund for Agricultural Development (IFAD) with debts of USD 61.7 million and USD 39.7 million, respectively. (Note: All of this debt is at highly concessionary interest rates. End Note.)

COMMENT: SLOWER GROWTH LIKELY AS CONSTRUCTION DECLINES

18. (SBU) The past six months have been marked by impressive growth and overall positive indicators for the Armenian economy. Improvements in tax collection have made more resources available for much-needed public expenditures in the fields of education and science, though overall spending remains inadequate to meet local needs. While growth is likely to remain strong for the remainder of the year, the double-digit growth that Armenia has enjoyed over the past four years is probably not sustainable. The European Bank for Reconstruction and Development representative is particularly concerned about the construction boom which has focused primarily on high-end residential real-estate. Given that construction is the primary driver of GDP growth in Armenia, as demand for new high-end residential space tapers off in the next few years, GDP growth rates are likely to decline.

GODFREY